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August 9, 2007

VIA FEDERAL EXPRESS & EMAIL

Illona Jeffcoat-Sacco
Executive Secretary
North Dakota Public Service Commission
State Capitol
Bismarck, ND 58505

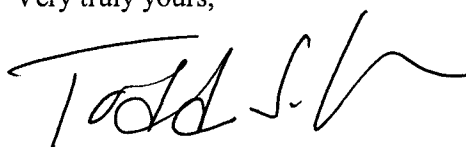
**Re: Montana Dakota Utilities Co., and Otter Tail Corporation; Advance Determination of Prudence, Big Stone II Generating Station
Case Nos. PU-06-481 and PU-06-482**

Dear Ms. Jeffcoat-Sacco:

Enclosed for filing please find Applicants' Response to Commissioner Wefald's July 16, 2007 letter.

Thank you for your consideration.

Very truly yours,



Todd J. Guerrero

TJG/kas
c: Attached Service List (w/encl.)

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Corporation and Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc., Advance Determination of Prudence Application

APPLICANTS' RESPONSE TO JULY 16, 2007 LETTER BY COMMISSIONER SUSAN WEFALD

Case Nos. PU-06-481, PU 06-482

Background

On July 16, 2007, Commissioner Wefald sent the parties in the above matters a letter seeking additional information as part of her consideration regarding the prudence of the Applicants' investment in the Big Stone Unit II. Specifically, Commissioner Wefald asked the parties to explore the consequences of having the Commission require Otter Tail Corporation and Montana-Dakota Utilities Co. ("Applicants") to implement additional demand-side management programs and commit to renewable energy sources, each in North Dakota, as a way of offsetting the increments of capacity and energy the Applicants would otherwise be entitled to from their proposed ownership of the Big Stone Unit II.

The letter provided two hypothetical examples upon which the Commission would conditionally approve a portion of the Applicants' Big Stone Unit II baseload ownership requests based on whether the Applicants committed to additional demand-side management/conservation and renewables in North Dakota.¹

Applicants' Response

At the outset, Applicants' appreciate Commissioner Wefald's interest in exploring opportunities for DSM/conservation and renewables in North Dakota. The Applicants share her interest and believe that where opportunities exist for cost-effective DSM and renewables within the state, the Applicants are committed to exploring those opportunities.

With respect to the idea of conditioning approval of a portion of the Applicants' proposed ownership interest in the Big Stone Unit II project on implementation of actual additional DSM and renewables, and that they be required to be located in a particular state, the Applicants believe

¹ The first example assumed the Commission approving only 75% (90 MW) of each of the Applicants' proposal, with approval of the remaining 25% (30 MW) conditioned on implementation of 15 MW of new demand-side management programs and 15 MW of renewable energy development, all in North Dakota. The second example assumed the Commission approving only 60% (72 MW), with approval of the remaining 30% (48 MW) conditioned on implementation of 15 MW of new demand-side management and 33 MW of renewable energy development, again all in North Dakota.

such conditions would be unwarranted. Aside from the practical business problems such conditional approval would present to a multi-owner project where each owner's respective share is set by contract, our response requires a brief explanation of how the companies conduct their resource planning in general, and the companies' resource plans specifically.

As the Commission is aware, both Applicants are integrated, multi-state utilities that conduct their resource planning on a system-wide, integrated basis. The companies pursue strategies that they determine will maximize efficiencies and are the most reliable over the long term for all of their customers, regardless of which state the customers are located in. As Advocacy Staff rightly point out in its August 3, 2007 initial brief filed in these matters, the prudence of a utility investment decision is based on the reasonable person standard: utility managers must exercise the same judgment, discretion and care that a reasonable person would exercise under the circumstances prevailing at the time the decision is made.² The location of that resource is, or should be, largely irrelevant.

It is equally important to recognize that while the Big Stone Unit II project is the subject matter of the current docket before the Commission, the resource plans of Otter Tail and Montana-Dakota comprise much more than just Big Stone Unit II. For instance, Otter Tail's resource plan includes not just the Big Stone Unit II project, but also includes a 50 MW purchase from Manitoba Hydro, to begin at the same time as the companies are expecting Big Stone Unit II to be able to come on-line. The Otter Tail resource plan calls for the total addition of 166 MW of capacity (summer rating – 116 MW of Big Stone Unit II and 50 MW of MHEB). Otter Tail's resource planning model determined that Otter Tail's increment of Big Stone Unit II was more economic than the Manitoba Hydro purchase. Thus, efficient resource modeling would dictate that the implementation of any additional DSM and renewable resources by Otter Tail in North Dakota (or anywhere else) would back off increments of the less economic 50 MW Manitoba Hydro purchase *before* such additions would impact Otter Tail's ownership interest in the Big Stone Unit II project.

Commissioner Wefald's hypothetical scenarios raise other questions too. In addition to the low-cost energy the Applicants expect to receive from Big Stone Unit II, the Applicants will also be counting on the capacity that the unit will provide to help them fulfill their reserve sharing obligations under MAPP. Based on the relatively low accreditation values that MAPP attributes to typical wind projects (approximately 15-20% of nameplate capacity), the 15 MW of renewable energy in Commissioner Wefald's first example would need to compare to approximately 100 MW of nameplate wind generation (using summer ratings). The 33 MW in the second example would need to compare to 220 MW of additional nameplate (using summer ratings) wind generation. Unfortunately, seeking to condition the Applicants' interest in a baseload resource that has been shown through our respective resource planning processes to be least-cost and needed by requiring, or "forcing" incremental, intermittent renewable energy into the system is inconsistent with the goals of least-cost, integrated resource planning.

Indeed, it is unclear whether this renewable generation would be *in addition to* the 160 MW of renewable resources that Otter Tail, for instance, already has identified in its resource plan

² Advocacy Staff Post hearing Brief, at p. 6. See also, testimony of Advocacy Staff witness Terry Deason, TR. Vol. III, p. 704, lines 1-12 (the most economic and reliable resource is key, not the location).

for implementation in the next few years. If so, the renewable energy requirement in the two examples might overlook potentially severe consequences to ratepayers and the companies' resource mix. For example, what are the impacts to the transmission system and what are the costs to rectify or address those impacts? As was pointed out in the hearing, building transmission for wind projects that seek equivalent capacity values require approximately 2.4 times the amount of investment, all else being equal.³ Such impacts would change the economics of the resource plan and likely increase rates to ratepayers. Additional resources would also be required to provide sufficient backup for the wind generation when the wind isn't blowing. Such resource additions would in all likelihood impact the companies' entire resource plan and not just their share of Big Stone Unit II. Unfortunately, such determinations cannot be made without going through the process of developing an entirely new resource plan and arbitrarily forcing the plan to accept the hypothetical DSM and renewables set forth in the two examples.

With respect to DSM, the companies' resource plans already include increased load management and conservation. Commissioner Wefald's letter does not distinguish between load management and conservation, but both types of resources are part of DSM technologies. Otter Tail, for instance, already manages a robust portfolio of DSM/load management in all three of its states and its integrated resource plan includes continued reliance on DSM. In the area of conservation and efficiency, Otter Tail currently manages a full portfolio of conservation activities and programs in Minnesota. At the request of the South Dakota Public Utilities Commission, Otter Tail is also awaiting approval of a conservation portfolio it has proposed in South Dakota.

Montana-Dakota has also implemented interruptible rates and launched a number of DSM programs, including a program promoting high-efficiency residential air conditioning and a commercial lighting retrofit program estimated to provide a demand reduction of 11 MW as reflected in Montana-Dakota's forecasted requirements. Montana-Dakota has identified nine separate programs, including appliance rebates for new efficient appliances, expanded interruptible service arrangements, and commercial air conditioner cycling efforts that it will implement in its integrated electric system, including North Dakota, and that are expected to provide additional annual demand reductions of 13.8 MW. Annual energy reductions of approximately 6 million kWh are associated with all the measures.

And while the companies are committed to exploring increased opportunities for DSM and conservation with in North Dakota, it is important to keep in mind that when it comes to implementing DSM programs, it truly is a shared responsibility between the companies and their customers. DSM, energy efficiency and conservation programs cannot be effectively implemented without willing customer participation. Over 30% of Otter Tail's customers, for instance, are already participating in some form of DSM, a significant accomplishment and one to which many other utilities throughout the country strive. It is also important to keep in mind the rural nature of much of the companies' service territories. It should be no surprise to this Commission that participation in conservation programs is higher in more densely populated areas than more rural areas.

³ TR. Vol., p. 432.

Last, it is instructive to point out that even under optimistic scenarios, the Applicants' resource plans demonstrate that increased conservation efforts would not offset the need for additional generating resources.

In sum, because the Applicants' resource plans include much more than just their increment of Big Stone Unit II, and because of the inter-relationship of *all* resources within the companies' resource plans, it would not be appropriate to tie the implementation of additional DSM and renewables to the prudence of Applicants' proposed ownership shares of Big Stone Unit II. More than anything, forcing such resources into the companies' resource plans would impact other resource additions, not Big Stone Unit II. It would also be a departure from any known regulatory theory if the prudence determination by a state regulatory commission regarding an investment in needed utility infrastructure were conditioned on incremental investment in the commission's home state.

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Corporation, Advance
Determination of Prudence
Application

AFFIDAVIT OF SERVICE

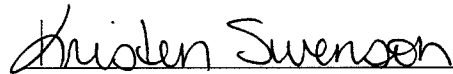
Montana-Dakota Utilities Co.,
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Kristen Swenson, of Minneapolis Minnesota, Hennepin County being sworn, says that on August 9, 2007, a copy of the following documents:


1. Applicants' Response to July 16, 2007 Letter By Commissioner Susan Wefald; and
2. Affidavit of Service.

have been served upon the North Dakota Public Service Commission and the attached service list via United States mail and by email.



Kristen Swenson

Subscribed and sworn to before me
this 9th day of August, 2007.



Notary Public



STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Otter Tail Corporation, Advance
Determination of Prudence
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SERVICE LIST

Montana-Dakota Utilities Co.,
a Division of MDU Resources Group,
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Application

Case Nos. PU-06-481, PU 06-482

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